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COMMONWEALTH OF VIRGINIA

STATE CORPORATION COMMISSION

AT RICHMOND, SEPTEMBER 14, 1999

APPLICATION OF

VIRGINIA-AMERICAN WATER COMPANY

CASE NO. PUE970523

For a general increase in rates

FINAL ORDER

By order dated December 22, 1998, ("Order") the Commission remanded this case "to give the Company an additional opportunity to present evidence as to the reasonableness of the affiliate expenses . . ." of Virginia-American Water Company ("Virginia-American" or "Company"). Virginia-American is a subsidiary of American Water Works Company, Inc. ("AWWC" or "Parent"). American Water Works Service Company ("Service Company") is also a subsidiary of AWWC and provides administrative, professional, and technical support to the Parent's water companies, including Virginia-American.

By Hearing Examiner's Ruling of January 28, 1999, a procedural schedule was established and a hearing set for May 24, 1999, before Hearing Examiner Howard P. Anderson, Jr. Counsel appearing at the hearing were: Richard D. Gary, Esquire, and Michelle K. Walsh, Esquire, for the Company; Edward L. Flippen, Esquire, for the City of Hopewell ("Hopewell"); Louis R. Monacell, Esquire, for the Hopewell

Committee for Fair Utility Rates ("Committee"); and Marta B. Curtis, Esquire, for the Commission's Staff.

In support of the affiliate expenses, the Company presented the testimony¹ of Patrick L. Baryenbruch, president of Baryenbruch & Company, a public utility consulting firm. As a result of that study, Mr. Baryenbruch concluded that Virginia-American could not function without the services that are provided by the Service Company and that such services are necessary to provide water utility service to the Company's customers. Mr. Baryenbruch also concluded that there is no redundancy in the services provided by the Service Company and the activities performed by Virginia-American and that the charges Virginia-American pays for such services are based on the Service Company's costs.²

The Commission Staff analyzed Mr. Baryenbruch's conclusions and found that it was reasonable to include the Company's affiliate expenses in rates. Staff's review showed that the costs billed to Virginia-American by the Service Company are lower than the market price for equivalent services. Staff, therefore, concluded that ratepayers should achieve savings through the Company's affiliate arrangement.

¹ Pursuant to prior agreement by counsel, Mr. Baryenbruch's study and testimony, as well as Staff's testimony, were admitted to the record without cross-examination.

² Ex. PLB-34 at 4-5.

It was Hopewell's position that the Company had not met its burden of proof as to the reasonableness of such expenses as there was no data in the record as to the costs of the Service Company. The Committee had no position on the issue of affiliate expenses.

On July 30, 1999, the Examiner filed his Report. In his Report, the Examiner found that:

(1) The twelve months ending December 31, 1996, is an appropriate test period for the case;

(2) The Company's test year operating revenues, after all adjustments, were \$25,236,174;

(3) The Company's test year operating revenue deductions, after all adjustments, were \$20,208,911;

(4) The Company's test year operating income and adjusted net operating income, after all adjustments, were \$5,027,263 and \$5,019,936;

(5) The Company's affiliate expenses should be included in the Company's rates;

(6) The Company's end of test period rate base, after all adjustments, is \$58,900,613;

(7) The Company requires additional gross annual revenues of \$776,251;

(8) The \$776,251 rate increase should be allocated as follows: Alexandria-\$171,912; Hopewell-\$329,596; and Prince William-\$274,743; and

(9) The Company should be required to promptly refund, with interest, all revenues collected, but not already refunded, under its interim rates, effective November 3, 1997, in excess of the amount found just and reasonable in his Report.

In discussing the basis for his finding that the Company's affiliate expenses are reasonable, the Examiner relied on the Commission's decision in Application of GTE South Incorporated, Case No. PUC950019, 1997 S.C.C. Rep. 216, which established the lower of market or cost criteria for the determination of the reasonableness of such expenses. The Examiner noted that the Service Company bills Virginia-American at cost and that the Company has provided cost comparisons of services received from the Service Company with the services available from other vendors. The Examiner relied on Staff's analysis of such comparisons and its conclusion that ratepayers should achieve savings through the Company's affiliate arrangement. The Examiner also found that the Service Company is not charging any return on the services rendered to Virginia-American although the Commission has determined that a reasonable return is permissible pursuant to its decision in the above referenced proceeding.

By letter dated August 9, 1999, counsel for the Company stated that Virginia-American agrees with the findings detailed in the above-referenced Examiner's Report.

On August 16, 1999, counsel for Hopewell filed comments on the Hearing Examiner's Report. In its comments, Hopewell took exception with the Examiner's finding with regard to affiliate expenses. Hopewell argued that "Virginia-American has had two opportunities to demonstrate that its affiliate charges are reasonable but it has failed to do so." Hopewell asserted that "there is no evidence of the affiliate's cost and no evidence showing the allocation of such cost to Virginia-American." Hopewell asked the Commission to "deny inclusion of those costs in the Company's cost of service."

NOW THE COMMISSION, having considered the record and applicable law, is of the opinion that the findings of the Hearing Examiner are reasonable and should be adopted. We believe that the Company has met its burden of proof as to the reasonableness of the expenses charged by its affiliate.

The record in the original proceeding shows that those expenses are an allocated portion of the Service Company's actual costs with no mark-up for profit. Mr. Baryenbruch, the independent consultant, confirmed this point in his testimony on remand. In addition, the Baryenbruch study demonstrates that the Service Company's costs are below the market price for

similar services. Even Hopewell does not question such conclusion.

Contrary to Hopewell's assertion, there is also evidence in the record as to the methodology used to allocate Service Company costs to Virginia-American. There is testimony in the original proceeding and again in the remand proceeding that the methodology used by the Service Company to allocate its costs to the operating companies is based on direct assignment or on the number of customers. Such methodology was never challenged by Hopewell.

We note that further refunds are not applicable in this instance as the Company has already been directed to commence refunds pursuant to our Order dated February 1, 1999. The refunds so ordered are based on a revenue requirement which includes affiliate expenses and such refunds were due to be completed on or before September 1, 1999. Accordingly,

IT IS ORDERED THAT:

(1) The above-referenced findings of the Hearing Examiner are hereby adopted.

(2) Consistent with the findings detailed herein, the Company shall file with the Commission's Division of Energy Regulation revised tariffs designed to produce additional gross annual revenues of \$776,251. Such tariffs shall reflect the

following allocation: Alexandria-\$171,912; Hopewell-\$329,596;
and Prince William-\$274,743.

(3) Since there is nothing further to be done, this case shall be dismissed from the Commission's docket of active cases.